Larsen & Toubro Limited
Q3 FY19 Earnings Conference Call

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Moderator: Good day, ladies and gentlemen and a very warm welcome to the Larsen & Toubro Limited Q3 FY19 Earnings Conference Call. As a reminder, all participant lines will be in the listen-only mode. There will be an opportunity for you to ask questions after the presentation concludes. Should you need assistance during the conference call, please signal an operator by pressing '*' and then '0' on your touchtone phone. Please note that this conference is being recorded. I now hand the conference over to Mr. Arnob Mondal. Thank you and over to you sir.

Arnob Mondal: Thank you, Ali. Good evening ladies and gentlemen, a very warm welcome to all of you for the earnings call for Q3 FY19. I hope all of you have downloaded the analyst presentation which was made available on our website over an hour ago; because, we will run you through the presentation and then we will take any questions that you have in regard to the results.

We will go straight away to the presentation on Slide #2 on Disclaimer. We tend to make a number of forward looking statements which may or may not materialize due to circumstances beyond our control. So this is just to caution you that we could go wrong on those forward looking statements. I will take the entire disclaimer as read.

The presentation is divided into four parts, Group Performance Highlights, Group Performance Summary, Segment Performance and final slide on the Environmental & Outlook.

We now go to Slide #4 which deals with the Performance Highlights of Q3. I think we have done exceptionally well on all parameters during this quarter. Order book has grown by 5% on a very high base and is now Rs. 2,84,000 crores. Q3 Revenue has grown by 24%, EBITDA has grown by 27% and as a result of which, Profit After Tax has also grown by 37%. We did extremely well in all the parameters and the only thing that seems to stand out is a 12% drop in order inflows; However, one has to take into account that in last year, the skew between H1 and H2 was very heavy (ratio of 67:33), and this year we have the order inflow more evenly distributed and that is why we registered such a blockbuster growth in H1 of this year. Even after Q3 has degrown by 12% compared to Q3 of last year, we are still ahead of last year 9-monthly run rate by 16%. Some of the award decisions were also deferred, around Rs 20,000 crores award decisions got deferred to Q4 and beyond. Another point which I would like to place on the table here is that, prospect pipeline for Q4 is very healthy and that gives us confident that Q4 should not be a too bad a quarter. In any case, Rs. 42,000 crores of order inflow in Q4 translates in to a $6 billion worth of orders and getting that much of inflows in one quarter itself, is a no mean feat.

As far as the Order Book is concerned, what we have seen is that now all the large verticals in our Infrastructure segment, whether it be Buildings & Factories or Transportation Infra or Heavy Civil or Power Transmission & Distribution or Water & Effluent Treatment, all have become fairly sizable. The order book composition is fairly secular in the sense that all these large verticals within Infrastructure constituted anything between 12% to 15% each of the total order book and hence it is more evenly spread out, and it is not lopsided towards any particular business vertical. The revenue growth as I mentioned has been stellar at 27% and PAT of course is very healthy in excess of Rs. 2,000 crores for the quarter.

Moving to the next slide #5 on 9M performance, this is just for reference, but here again I will like to point out that order inflow growth is at 16% in spite of the 12% degrowth in Q3.

We will move to the next slide, Slide #6. Most of you would have seen this and this too is essentially for reference except for the fact that I would like you to note that Net Working Capital has actually marginally improved by 70 basis points and of course it is in the acceptable range of around 20%. For quite some time now, we have been telling markets that 20% of revenue or thereabout is an acceptable level of Net Working Capital as far as we are concerned in the existing circumstances. Unless the economy takes off, we don't expect much of an improvement, but we have managed to hold on to these levels. Our Return on Equity has also improved marginally. We will have to see how it pans out by the end of the year and should definitely show some improvement and we seem to be reasonably walking the talk as far as our ROE improvement plan up to end of FY21 is concerned.

We will now move to the next section which is Group Performance Summary. Slide #8 deals with Order Inflow and Order Book. Here again, I have already mentioned that this year the Order Inflows are witnessing less of a skew than we witnessed in the previous year FY18 and that to some extent is responsible for the 12% dip in order inflow growth for Q3. We still see public sector continuing to drive order inflows. While there have been some green shoots as far as private sector capex is concerned, it is not still very wholesome strong investment momentum in the private sector. Obviously, another thing that we have seen is that higher share of the domestic order book which is clearly an outcome of the continued focus by various public sector entities on infrastructure capex. Here again, I would reiterate that in Q3, apart from the skew, we also saw Rs. 20,000 crores worth of award decision getting deferred.

Slide #9 deals with Financial Performance, starting from Sales to Cost. Here, you would have seen a very healthy growth in Sales which is primarily contributed by Infrastructure across the board. Hydrocarbon has grown smartly which we will come to later. Realty again has contributed significantly to this which we will again deal with a bit later and of course our Services business which you would have seen the results of our listed subsidiaries L&T Infotech, L&T Technology Services and L&T Financial Services who declared their results rapidly over the last one week and all of you would have anticipated that Services would contribute very healthily to our revenue growth as well. If you look at staff cost, staff cost has gone up fairly significantly 20% during the quarter and 21% during the 9 months, but that is essentially driven by augmentation of manpower in our services business, since most of our services businesses are essentially manpower based.

The other parameters are Finance Charge Opex which is essentially the operating expenditure of Financial Services and Finance Lease, which has gone up primarily because of the healthy growth that Financial Services exhibited. As far as Sales & Admin expenses are concerned, you would note that there is a 12% drop in Q3 and overall 11% growth during 9 months. The drop in Q3 is essentially on account of lower credit costs both at the parent company level including Expected Credit Loss (ECL) that we provide for in accordance with the standards as well as lower credit cost in financial services. That has led to overall lower Sales & Admin for Q3. Even though there is 11% growth for 9 months, but that is only natural considering that a large part of the Sales & Admin expenses move in sync with revenue growth.

Going to the next slide, Slide #10 on EBITDA to PAT. I will first deal with EBITDA. Obviously, you will see a very strong growth in EBITDA, 27% for the quarter and 31% for the 9 months as a whole and this is essentially driven by our Services and Realty business. I will deal with the Realty part a bit later, but I think all of you are aware of how Services business has significantly grown their EBITDA as well as PAT.

Finance Cost has shown a bit of an increase. This is essentially commensurate with debt levels. As all of you would know, we have been increasing our debt, as we had a very volatile liquidity environment in Q3. We actually raised funds as buffer, which was invested in liquid investments, so investments have also gone up and debt has also gone up and the finance cost increase you see there is commensurate with the increased debt levels. We also had part commissioned another stretch of Hyderabad metro in Sept 2018 and that has also contributed to around Rs. 50 crores of increase in interest cost. Other income has gone up as well, obviously since we have invested fairly large amount in our current investments, in liquid investments, we have also earned higher treasury income from that.

We will go to the next slide, which is Segment Composition, Slide #12 and this is pretty much same as it was in earlier quarters as well. This slide is just for reference. Obviously, I will not read out every single word that is there but if anybody wants to refer to the sub segments of each segment, one can refer to this slide.

Now we will move to the next slide, which is Slide #13 which deals with Order Inflow composition. Order inflow as you would be aware was Rs. 1,20,000 crores in the 9 months. The Infrastructure as usual has the largest share which is 54%, and services was included for statistical reasons in Order Inflow as they are short cycle orders. Hydrocarbon has come to the party and they account for a good 13% share. As far as the geographical composition is concerned, Order Inflows from domestic is obviously a big driver with 76% share, Middle East constitutes 9% and US and Europe has essentially contributed by Information Technology (IT) and Technology Services (TS) verticals, even though Heavy Engineering also has some role to play in that.

We will go to the next slide #14. This slide is more for reference. It gives the composition of the Order Book. I think all of you are aware that Infrastructure is probably the elephant in the room as far as order book is concerned. Domestic has grown significantly and now it is close to 80%. Another point to note here is that now apart from Middle East, we also have Rest of the World (ROW) which contributes around 8% of our total order book compared to 13% in Middle East. Five years back, almost our entire international order book was Middle East, so we have consciously diversified into other geographies, essentially Africa and East Asia including Bangladesh, Sri Lanka and some other countries which are now bearing fruit.

We will now move to the next slide on Revenue Composition. This again is only for reference. Suffice to say that Rs. 96,000 crores of revenue is a very healthy number in the last 9 months, all of you know that and here again, I would like to point out that Middle East is contributing around 18% of this which is slightly down compared to earlier year because domestic revenue has seen significant traction. That is the only thing I would like to point out on this slide.

Now, we come to the next slide, Slide #16. In Infrastructure segment, you could notice that we have had a very strong revenue growth, which we witnessed across all business verticals within the infrastructure. Obviously, a robust conversion of the order book into revenue is due to efficient execution and to some extent due to supportive environment in most projects also aided us, where customers have been paying reasonably on time, which has enabled us to go ahead with execution without blowing up our working capital.

Margins reflect stage of execution and job mix. All of you are aware of our margin recognition policies, so to some extent that has an impact. We have taken significant cost provisions, primarily on account of some transportation infra projects and these are essentially due to either a prolonged work stoppage where we have incurred additional cost. We have raised claims on the client and in one case we got official extension of time but reimbursement of cost is still a grey area. In around 6 or 7 cases, we come across some projects where there were delays in land acquisition and right-of-way which has led to again time and cost overrun. So, what we have done is that while we have washed these cost provisions through the P&L in this quarter, fairly large amount, we have not accounted for the claims against these which we will account for the same, as and when we receive it and we do anticipate some of these will spill over into the subsequent years, so it may not come in Q4 itself. Of course, quantum of claims that we expect to receive will definitely surely be more than the extra charge that we have taken in this quarter, so overall it should even out. Needless to mention that it is only a quarterly blip which will not have an enduring impact on the segment as a whole.

We now move to the next slide which is Slide #17 dealing with Power segment and here I think everybody realizes that as far as coal fired power plants are concerned, the opportunity basket is very limited, hardly 5 to 6 Gigawatt is getting ordered out every year and there is aggressive competition for whatever limited opportunities are on offer. Coal fired power plant sector as a whole is witnessing this and obviously this continues to impact business performance. On principal, we would not like to bid very aggressively, where we don't earn any margins just for the sake of bagging an order. Of course, the revenue decline of 29% in Q3 reflects depleting order book, this particular segment is going through. International jobs have been contributing quite a bit now and particularly to higher margins as well, because jobs that we are currently doing in Bangladesh are fairly margin rich jobs. Under IndAS accounting standards that we follow today, profits of our Joint Ventures which we run with MHPS are consolidated under Equity method at a PAT level, so their operations are not consolidated in Revenue and EBITDA margins, even though it is fairly healthy. However, sole word of caution, we can may be run for a couple of years before we start seeing the traction happening in this sector, so we do think that we need to pick up some orders over the next one year or so.

Moving to the next slide which is Slide #18 which deals with the Heavy Engineering segment. Here, there has been a smart growth in revenue as you can see and the revenue growth has been predominantly driven by orders from both Oil & Gas as well as Nuclear power. Even the nuclear power is relatively small compared to oil and gas in this particular segment, they have also got healthy orders. The factory is fully loaded and as you can see substantial portion of the revenue has also been contributed by international markets. Around 65% of the 9 monthly revenues are from international markets and these are essentially from US and Europe. They have got over 40 reactor and reactor type equipment orders in hand which are currently being executed, so the factories are running fully loaded at this point of time and of course, international markets are showing strong traction in the refinery space and you would see that this business while it may not have blockbuster revenues has very healthy margins between 20% and 25% and this is because of the global competence that they have acquired over so many decades. They have technology differentiation, they have got a proven track record, as well as cost efficiencies which are also kicking in and are yielding strong margins.

The next slide is Slide #19 which is Defence Engineering. Here, you would have seen a fairly significant revenue growth of 36% during the quarter and 18% for the 9 months and this growth has essentially come from execution of tracked artilleries gun order and all of you would have read the fact that during the last week, the Prime Minister inaugurated our brand-new production line in Hazira where these guns are being rolled out. There is significant margin variation both in Q3 and 9 month between current year and last year and this is essentially due to stage of execution and job mix, not due to any cost or one-time adjustments.

We will now go to the Electrical & Automation segment on Slide #20. This segment as you know is essentially dealing with low voltage switchgear and to some extent medium voltage switchgear as well. Here, Q3 has seen a smart growth of 20% as far as revenues are concerned and what we have witnessed in this particular segment is that they have seen growth both from industrial offtake, offtake from the building segment, offtake from agriculture segment as well as from rural electrification segment where our meters typically go. So, there has been an all-round growth in Q3 and that has led to 20% growth in Q3 and 16% for 9 months as a whole. The margin has also improved slightly and this particular business has put in place a structural program of operational efficiencies and those are seeing improved realizations.

We will now move to the next segment which is Hydrocarbon slide #21. Here, you will notice that revenues have grown very well at 22% for the quarter and 32% for the 9 months. In Q3, domestic revenues have grown from Rs 11.5 billion to Rs 17 billion and in 9 months from Rs 32.8 billion to Rs 50.8 billion, so the maximum growth has come there and the composition of revenue trends that you see is in line with the increasing India centricity of order wins, that this business has been seeing for some time now, even though the Middle East order pipeline prospect is fairly healthy even today and we do expect that the prospect will remain healthy going forward as well. The strong revenue growth in this segment is due to efficient execution and we see that margins are fairly stable, for 9 months it is 8.5% compared to 8.4% last year. This business has delivered superior return on invested capital, again through execution efficiency.

We now move to the next segment, Developmental Segment slide #22. This is a complicated segment. This includes Power Development business essentially coal fired power plant in Punjab under Nabha Power Limited. It includes Hyderabad Metro and for the first quarter of the year, it included Kattupalli Port till such time we divested it. In Nabha, revenue growth has been registered due to higher PLF that we have seen in Q3. There has been a drop in margins in Q3 and this is essentially due to higher operating cost that we had in Nabha including some four shutdowns that we had, which led to higher cost. As far as Hyderabad Metro is concerned, we have had partial operationalization of the metro rail of 30 kilometres in November 2017 and 16 km in September 2018.

All of you would also be aware that IDPL assets which are essentially road assets and one transmission line asset is consolidated at PAT level under equity method and hence their operations are not reflected here.

Now going to the next slide which deals with IT and Technology services. I won't dwell upon too much because they have already declared their results and they have also had their own earnings call. Some of you may have listened to that but be that as it may, there is a very strong growth of around 30% both in Q3 and 9 months and this has been led by multiple business segments within L&T Infotech as well as in L&T Technology Services. Margins have also grown decently from 21.5% to 23.7% and this is essentially due to operational efficiencies that they have put in place.

The next segment is the Other segment, the segment comprises Industrial Products and Machinery (IPM) which is essentially Valves and Construction Equipment, Mining business, Realty business and some other smaller businesses and previous year included welding products which was divested. Here, the strong revenue growth of 77% in Q3 and 66% in 9 months has essentially been contributed by realty business. I will elaborate on that, but apart from that we have also seen a steady revenue growth in Construction and Mining Equipment business. All of you would be aware that after adopting IndAS 115 from 1st of April 2018, for the last 9 months our method of recognising revenue in Realty business has changed from percentage of completion method to completed contract method and we recognise revenue based upon handover of properties, essentially flats or commercial space. In Q3, we sold one commercial building, which has led to around Rs. 550 crore gain in both revenue and EBITDA.

We also had some sale of commercial property, not so much in Q3, but in Seawoods, we did some sale in 9 months, not very significant, but yes, it does contributed to top-line and bottom-line as well.

One thing, everybody keeps on wondering is on how much is coming from sale of flats, is it very lumpy, is it likely to continue, is it going to taper off immediately. Here, I would like to give you some idea of what we are doing as far as our residential projects are concerned. As far as residential projects are concerned, we have Emerald Isle phase 1 and phase 2 in Powai. We have got Crescent Bay in Parel and we have got Raintree Boulevard in Bangalore. I am not counting ones which could come on the anvil at subsequent date like maybe in Chennai, Powai West or may be even in Mulund. I am not counting those because those are irons in the fire which are yet to fructify, but if you take these three broad projects, four if you consider Emerald Isle phase 1 and phase 2, the total number of flats approximately delivered or still under construction is around 4000 flats, of which we have handed over around 1300 approximately. I am rounding it off, there may be 10, 15 flats differences here and there. Out of 4000, we have handed over 1300 flats which means that we are yet to hand over

2700 flats which are either built and hence under inventory or under construction. Out of 2700 flats that we are yet to hand over, 1700 of those have already been sold, that means we have already booked. Those flats have been booked, yet to be handed over and around 1000 flats are sitting as unsold inventory or under construction flat. I consciously give these data points to give you some idea on insight into future revenue and margin schemes arising from this segment and even though the revenues and margins may be a bit lumpy from quarter to quarter because it will depend upon when we hand over a full tower. Once we complete the tower, then we start handing over, so it will be lumpy, but the fact is that we do have a decent line of sight into future revenues and margins in this particular segment.

Moving to the next slide, L&T Finance Holding Group, I will not elaborate on this except for the fact that they did extremely well in a very difficult quarter and this business actually successfully navigated a very volatile liquidity environment sometime before Q3, started sometime in September and I think everybody is aware of what the IL&FS saga did to liquidity. Almost froze at one point of time, then it gradually started giving release and from around mid-December onwards, it started easing to quite an extent especially for good NBFCs with good parentage. This business, as reiterated earlier, focus is on increased retailisation of the loan book. As you can see, the loan book is close to Rs. 95,000 crores today. Maintaining or increasing the Net Interest Margins (NIMs), containment of credit cost, which they have done very admirably, as well as the management of the asset liability maturity mismatch and interest rate management and finally the overarching goal is to deliver superior return on equity (ROE).

Before I go to the Environment & Outlook slide, I just like to briefly touch upon some slides in the annexures, so I request you to go to is Slide #30. Here, we have given the disaggregated balance sheet, essentially because the largest numbers here are on account of debt. You can see that Financial Services accounts for a good Rs 86,000 crores worth of debt in our total balance sheet of Rs 1,93,000 crores of total balance sheet size. Of course, they also have a corresponding large loan book as well. One point to note here is that all the other debt combined, if you step out debt of Financial Services and our concession business, whether it be Hyderabad metro or Nabha, we have Rs 22,600 crores worth of debt in all other entities and we are also holding cash and liquid investment of close to Rs 24,000 crores. That is the second last line item. So, from a liquidity point of view and balance sheet sense point of view, I think the consolidated balance sheet exhibits considerable strength.

I like you to go to the next slide which is Slide #31 which deals with the cash flow. Here, you can make out that we have had both in Q3 as well as in 9 months, we had strong operating cash flows of Rs. 18.6 billion in Q3 and Rs. 29.5 billion for 9 months as a whole, very strong and this is primarily a reason because as you can make out changes in working capital have not eaten away our free cash flow as they used to in the past quite a bit. Another point to note here is that while debt has increased if you see net cash from financing activities, you see that debt has increased in Q3 by around Rs 2400 crores whereas if you look at the net cash using investing activities, increase in liquidity investments has also increased by around Rs 2900 crores, so just to give some highlights of the cash flow.

If you go to the next slide, which is Slide #32, here point to note is that in Q3, as far as IDPL group is concerned, Q3 losses have reduced and this is driven by the divestment of 5 road projects which we did earlier in the month of May to an InvIT, which reduced the losses in this quarter compared to Q3 of last year as well as IDPL also had some treasury gains because they have fruitfully deployed the large part of the cash that they have got from InvIT. MHPS JVs are PAT positive, both have earned together slightly over Rs 100 crores at PAT level, both Turbine as well as Boiler are PAT positive and of course forge shop's EBITDA this year is positive.

We will just go to the Environment & Outlook slide #27, here of course many of the people were pointing out that this slide is too complicated, so I will not elaborate on everything apart from I think the structure of the slide is self-explanatory. We think we have an economic moat around the business drivers which are all geared towards improving ROE over the strategic plan duration. Now, while I have listed a number of areas which affect us directly or indirectly outside our own company which are essentially the external environment factors. Many people have told me about lots of concerns that they have had and the concerns have been rotating around volatility of oil prices, currency, current account deficit, possibility of fiscal slippage, the effect of global trade wars, possibility of fractured mandate post general elections in May 2019 and of course the recent concern of everybody was liquidity, but in spite of all that, we are still seeing strong investment momentum in the areas of road and road adjacencies. I make sure I mentioned the word road adjacencies because things like expressways, Mumbai Trans Harbour Link, flyover projects, tunnel projects, special bridges, etc are all non-NHAI orders actually which are very important for us. We are seeing strong investment in metro rail networks, we are seeing strong investments in water resources management, in waste water, in irrigation and in rural electrification as well as in hydrocarbon. So, these are areas, all of which are very strong macro drivers.

One thing I would like to point out is that I think the large structural reforms whether they be demonetization, GST or IBC are well in place and these are leading to increase in tax revenues and widening of the tax base, formulization of the economy as well as I think as and when the IBC cases get resolved, we are seeing more and more credit growth likely to happen, some part of which is already happening and of course, we think that irrespective of what happens, focus on infrastructure build-out will continue.

Now, finally I would like to touch upon our guidance. As far as order inflows are concerned, we have guided for 10% to 12% and considering the prospect pipeline that we see, we still think that we should be able to meet our order inflow guidance. We have guided for revenue growth of between 12% to 15% and we think that we will surely meet the lower end of the guidance, but we are likely to move towards the upper end of the guidance. As far as EBITDA margins are concerned, we guided for up to 25 basis points improvement excluding services business and in spite of the 250 basis points drop in infrastructure margins that we have seen in Q3, we still think that we will overall be in that band of up to 25 basis points, whether it is 10 basis points or 15 basis points or 25, it is too premature to say, but at this point of time, we are holding on to our original guidance, even though infra could be a bit lower. So, with that, I would now like to open the session to any questions that you may have. Over to you, Ali.

Moderator: Thank you very much. Ladies and gentlemen, we will now begin the question and answer session. The first question is from the line of Venugopal Garre from Bernstein. Please go ahead.

Venugopal Garre: Your presentation commentary was very detail, ended up answering most of our questions, but just wanted to check if you could quantify the infra provisions given that you have given details on that. Just to get an idea of the quantum?

Arnob Mondal: I think the total extra provisions that we have taken in this quarter is around Rs 400 crores approximately.

Venugopal Garre: And also, I was just seeing that today Supreme Court sort of mentioned that operational creditors in all these NCLT cases would not be taken at par with this financial creditors, so I remember couple of quarters back we had some provisions which we had taken on account of some of these projects which were supposedly heading into bankruptcy code. So, are we provisioned fully for any such cases or is there some issues that still could have an impact?

Arnob Mondal: Very good question, Venu. We are fully provisioned in all cases.

Venugopal Garre: If I may just ask on the buyback, I think this is going to be a key question that people would like to ask, what is the situation looks like you can never do a buyback if L&T Finance is part of the business, so what are the other methodologies being thought of? That is my last question.

Arnob Mondal: Don't think one can really jump to any conclusions like you can never do a buyback. Firstly, all you know our core business may grow to such an extent that our net worth goes up substantially and even after buyback we are less than 2:1, even after you consider SEBI norms. Secondly, the number of options are open to us. We can again reopen a dialogue with SEBI, we can always approach them, tell them that the direction that they have given is based upon their own internal guideline which frankly speaking to our assessment, it is not backed by law. We can always think about approaching SAT if we want to and may be at some part of time, we could again raise the issue once again, even though we have enough time to appeal. Even if you decide not to appeal at this point of time, at some point of time, we could again apply for a buyback. So, I don't think any knee jerk reaction is either required or not desirable at this point of time, but I don't think you should shut the doors. It would take an extreme view that the doors of buyback are shut forever.

Moderator: Thank you. The next question is from the line of Inderjeet Bhatia from Macquarie. Please go ahead.

Inderjeet Bhatia: Couple of questions, my first is on the topline growth, even if you are talking about the top end of the guidance, you are talking about pretty much of flattish quarter in Q4, is there a worry that because of elections there is a likelihood of a sharp slowdown in execution, is that or you just not being cautious here while you give the guidance?

Arnob Mondal: Actually, I think Q4 is a very heavy quarter, in fact just to meet the upper end of the guidance, we will require in excess of Rs 42,000 crores worth of revenue in Q4 alone. That itself is a steep ask by any standard irrespective to meet the upper end of the guidance and while we do think that there could be a bit of slowdown in the government machinery due to elections, I don't think anybody, neither you nor I have any idea of whether it will really affect our execution or not because ultimately our execution is based upon whether customers pay us on time or not. If they pay us on time, then we will go ahead and execute. If they delay payments, then we will obviously slowdown execution. At this point of time, the environment is a bit uncertain both on ordering as well as on revenue, but we are fairly sure that we should at least touch the upper end of our revenue guidance.

Inderjeet Bhatia: The second question is regarding this provision that we have done in infrastructure segment, are these more in nature of just the timing mismatch that we have raised claims, customer is up to kind of revert or are these more like disputes that we have with customers?

Arnob Mondal: No, these are not really disputed claims. In one case actually, the customer has given us a formal extension of time because of delays on their part, but they are not paying us additional claims and we may have to go to arbitration. That we are not sure at this point of time, we have raised the claim on them, so all of these cases are essentially those where we have run up against time and cost overruns, not disputes as such with clients.

Inderjeet Bhatia: So, barring one client, in other cases it is not a dispute?

Arnob Mondal: No, other cases as well. This was the large project where we have provided for, where we have got formal extension of time, but not the cost. Normally extension of time comes along with the commitment to reimburse costs on variation claims.

Inderjeet Bhatia: Typically, transportation projects, these all would again various government customers, right?

Arnob Mondal: Yeah, all are government, in fact there are some international jobs as well where we have taken some provisions, couple of international jobs as well and domestic, but all are government.

Moderator: Thank you. The next question is from the line of Renu Baid from IIFL. Please go ahead.

Renu Baid: Two questions, one if you can just, I missed the number you mentioned, what was the contribution of Realty in the third quarter and for the 9 months from 66% you had mentioned 77% in 3Q and 66% growth in 9M?

Arnob Mondal: That was the other segment as a whole. Realty, the total revenues were close slightly less than Rs 950 crores approximately in Q3 and around Rs 2500 crores for 9 months as a whole.

Renu Baid: And last year, what would this number roughly be?

Arnob Mondal: That I don't have right now, but it would be around Rs 600 for 9 months.

Renu Baid: Second would be sir, if you can help us, then you did mention the prospect list continues to remain fairly strong and we were expecting Middle East to be a good contributor to inflows in the first calendar year of the year, so can you share some more details on segment wise, how large is the prospect list and which are the segments, domestic, international that we are expecting to contribute?

Arnob Mondal: As far as the prospect list is concerned, excluding product businesses and services which also gets added to order inflow, even if you exclude that we are looking at something like Rs 1,60,000 crores worth of prospects of which Rs 100,000 crores is approximately on infrastructure barring Power Transmission & Distribution which we generally look at as part of power, so Rs 100,000 is there, spread between Building & Factories, Heavy Civil, Transportation Infra, water Effluent Treatment plant and of course Smart World and Communication as well. So, around Rs 100,000 crores is there. Around Rs 30,000 crores are there in Power, major part of which is Power Transmission & Distribution which would be around Rs 25,000, Rs 5000 would be EPC power. Around Rs 10,000 crores worth of prospects are there in Metals & Metallurgical, around Rs 15,000 crores of prospects are there in Hydrocarbon and Rs 5000 crores in Heavy Engineering and Defence. That is how the Rs 1,60,000 crores gets added.

Renu Baid: And sir, just qualitatively how are you seeing the activities in the Middle East space despite oil prices being relatively volatile or do you see large customer like Saudi Aramco continuing with the large projects, what is the feeler there both on oil and gas as well as infra space?

Arnob Mondal: As far as oil and gas is concerned, we are still seeing strong investment momentum in the Middle East, both whether it be Saudi Aramco or some other countries as well. As far as Infrastructure is concerned, it has not been very strong but it is not zero either, in fact some parts of Etihad Rail now getting tendered out which is the first of the GCC rail that went into coal storage when oil fell to $40 a barrel, so even that has started, but it is not all that robust as such.

Renu Baid: Any Forex adjustments in this quarter or it was broadly normal?

Arnob Mondal: No, it was broadly normal. I think there was something like Rs 30 crores forex gain approximately.

Moderator: Thank you. The next question is from the line of Sumit Kishore from JP Morgan. Please go ahead.

Sumit Kishore: Very strong set of execution, cash flows and even inflows in this environment. My first question is on the Realty segment again, can you quantify the sale of commercial property and the contribution it has had on revenue, EBITDA and profit in third quarter?

Arnob Mondal: That building that we sold that was the one-time sale, that was around Rs 550 crores approximately revenue and that falls to the EBITDA line because that was being held as an asset, so it is getting accounted for by way of profit on sale of that asset. So Rs 550 crores is there in revenue as well as in EBITDA.

Sumit Kishore: So, this sale of building is specifically a residential project that you are talking about?

Arnob Mondal: Commercial property

Sumit Kishore: It is a commercial property?

Arnob Mondal: It is a commercial property. This is a profit on sale.

Sumit Kishore: Profit on sale and this is specifically, what property are we talking about?

Arnob Mondal: This was what we call a Technology Tower that we had built, we are waiting. We were negotiating for quite some time. We just saw happened that it happened this quarter. We sold the entire building.

Sumit Kishore: My second question is, are there any order cancellations which have happened in the third quarter?

Arnob Mondal: Nothing very much. See, every quarter we do some small clean up here and there, so maybe, at best I think couple of Rs 1000 crores, around Rs 2000 crores of orders were removed, which were old order not moving.

Sumit Kishore: And in terms of provisioning in the infrastructure segment, I know it is an ongoing activity, but would you say that bulk of the claims in the infra segment for the transportation infra projects in question have already been provisioned for?

Arnob Mondal: No, when I say claims, these are claims raised on clients, but point is that even though the accounting standards allow you to account for the claim as revenue if you have reasonable certainty, internally we follow more stricter norms saying that only the customer agrees to pay the claim then we account for it. So, while we have booked the additional cost provision through the P&L, but claims as and when customer pays as we will account for those as a credit to the P&L going forward.

Sumit Kishore: If you have been conservative and if you have not accounted for revenue against the claims that you would have in the infra segment?

Arnob Mondal: Yes, correct.

Moderator: Thank you. The next question is from the line of Nitin Bhasin from Ambit Capital. Please go ahead.

Nitin: This is Nitin. Few things when we say that in terms of the outlook looks very good right now, just look at the political cycle in the last 2 to 3 years. It has actually led to a lot of stuck orders of the past, remember when this government came in. When you are looking at the pipeline, the one is one-year pipeline looks very good, but do you think 2 to 3-year pipeline because where we are today is a very massive order inflow, can such sort of an order inflow continue for 2 to 3 years?

Arnob Mondal: That is rather like trying to do a bit of crystal ball gazing Nitin, very difficult question for me to answer, but I will try to answer it as best as I can. So, the way we look at it is that I think you would also realize that percentage of spend that infrastructure has compared to the size of the economy is relatively small compared to many other economies in the world. Secondly, I think if you look at while the central government, I am talking about now budget arithmetic, government budgeted for a net increase in tax revenues after parting with their share to the states under the 14 Finance Commission. They have budgeted for net increase in this year FY 2019 of Rs 2,11,000 crores. Now to put in perspective, the total allocation towards the infra was barely slightly more than Rs 3 lakh crores; however, the large part of the Rs 2,11,000 crores budgeted increase in tax revenues has gone to the social sector, so to say but this Rs 2 lakh crores, even if it falls short, I know that GST run rate is falling short of what they have budgeted, so they may fall short by Rs 20,000 to Rs 30,000 crores, I am not sure how much, but even then Rs 2 lakh crores is not going to disappear. Going forward that is only going to increase as and when more and more of the economy start getting formalized. Now if you look at absolute numbers, Rs 3 lakh for allocation on infrastructure, Rs 2 lakh crores additional tax revenues. At some point of time, I suspect that they will start allocating more to infra. It will give them a wherewithal, so on that front and the macro drivers are there, very strong macro drivers, I think we have discussed it in past meetings. Macro drivers are very strong in India as perpetually under invested in all areas of infrastructure and it shaves off good percentage number from GDP growth as well. I agree that the political outcome may be uncertain, but our sense is that irrespective of the political outcome, focus will be there on infrastructure build out and we are so under invested as a country. I think yes, there will be sufficient headroom for growth in multiple areas and we are not even talking about private sector picking up in a big way, which probably will happen after elections are over and if consumption starts moving as well.

Nitin: So, any sense on the factory orders that you are getting right now, any segment giving you like Rs. 500 crores factory order, anything in the country barring cement because those guys are doing expansions under their own problems, but nothing is coming through, so that means that and gradually?

Arnob Mondal: We have got some orders in metals, but frankly factory buildings don't really give us much traction as far as order inflows. As you mentioned, there could be around Rs 400 crores to Rs 500 crores. These are not Rs 4000 crores of orders and when we are looking at 1.5 lakh crores of order inflows on a regular basis, it doesn't really swing the needle for us, but I suspect that if you look at private sector, whether it be PPP where we don't get too much orders barring some airport orders which we have been getting which I think that is a bit of bright spot, but road orders, PPP orders we don't get much from winners. As far as industrial is concerned, metal seems to be a bright spot. Other areas of industrial capex, I think you will need to watch the last RBI numbers on capacity utilisation which I think was 76.1%. I think you will have to cross 80% at least before that starts to pick up. Consumption led capex, I think we are not yet at a stage of consumption boom and Nitin, you know that we are always very late cycle beneficiaries of consumption boom. People by more and more cars at some point of time, Maruti will put up another factory, but that will happen only when there is a full-fledged boom, so we are yet to see that.

Nitin: This is what I was trying to actually allude to it and if you see largely the profit are actually getting very much concentrated on the Realty, Infrastructure and civil, though the numbers of and hydrocarbon and heavy engineering are looking good right now, but the needle is not becoming very big over there also. The infrastructure remains very punchy and share at 75 to 78%, although overall?

Arnob Mondal: I agree with you Nitin, but you must consider that within infrastructure, we have got 5 verticals, each of which run like independent large organizations by themselves, whether it is Heavy Civil or Power Transmission & Distribution or water, any of them. All of them are very strong business verticals and they operate in very discrete segments. There is not much overlap between say Water and Roads as such.

Nitin: And with the revenue of share of the domestic now settling to where it is because international is not expanding, you are settling at margins of 7.5%, is that like good margin with plus minus 50 bps is that what one should look at, at that particular segment?

Arnob Mondal: By FY21, which is the end of our current 5-year set line, you will see a bit of bump up in margins coming from productivity improvements across the board.

Nitin: In infra productivity improvement, you have been talking about it for about year and year and a half and the revenue the way it has increased we haven't seen much of an infra segment EBITDA margin increase.

Arnob Mondal: 50% of our total order book are fixed price contracts and you know how commodity prices, particularly steel has hit us today. Steel is around Rs. 56,000 a tonne. It has gone up substantially and in our fixed price contracts we had to absorb that but at the same time, I have not been talking about productivity improvements all there, but it is a slow process. For example, if we have to sensorize 25,000 pieces of equipment's and put every single equipment on the IOT platform to measure utilization that cannot be done overnight, it has to be done over a period of years if we have to sensorize all the workers working on a project to tap that. That also will take a few years, so that is why I am saying wait till to the FY21.

Nitin: So, you know, last one from Hyderabad metro, you mentioned in the developmental project slide that the revenues were closer to about Rs. 6 billion for the 9 months, so how should one look at the full year roughly, next year and if you could share the PBT number of Hyderabad metro for this year till now, 9 months?

Arnob Mondal: PBT actually, EBITDA was around Rs 75 crores for 9 months, EBITDA.

Nitin: That will be very high because I just trying to understand the interest cost on the depreciation charge on that?

Arnob Mondal: I think you wait for some time, middle of next year, we will be able to give you a much better position.

Nitin: So Rs 2.3 billion of Hyderabad metro revenue becomes like steady quarter number and this would actually go even more in the Q4 and Q1 next year?

Arnob Mondal: Next year, it should go up as and when we start commissioning more and more phases, it will go up obviously and as and when network effect of traffic kicks in.

Nitin: And what is the debt on metro today?

Arnob Mondal: Debt on metro, Rs 11,000 crores approximately.

Moderator: Thank you. The next question is from the line of Ashish Shah from IDFC Securities. Please go ahead.

Ashish Shah: Just one question on the order inflow, there seems to be a large part of orders, which were not announced, I mean if you see the gap between announced and the reported order inflow, any key orders that you might want to highlight which formed part of the inflow and were not announced?

Arnob Mondal: See Ashish, if you not announce it, it is for a good reason, correct.

Ashish Shah: I understand, may be now the quantum but at least qualitatively.

Arnob Mondal: See, I can't go against our corporate norms and the reason why we don't announce is that we can't announce an order unless it has a formal clearance from the client and very often clients, either they give the clearance which is far too late, they will give it when the next quarter results are to be declared or they say no, you please don't talk about it, we will inform the market when we want to. So, it is not in our hands actually, so I will have to disappoint you on that front.

Ashish Shah: Just one more thing, more from the number's projection purpose, so this quarter we have seen a big spike up in the other income and also in the interest cost, now is this situation likely to continue or we going to keep on holding to the high level of cash and investments as well as the borrowings or we are going to unwind them as we end the Q4?

Arnob Mondal: Ultimately, a large part of the cash would have got vacated if we had managed to get permission for the buyback, but since that has not happened, all options are on the table at this point of time. So here again, it is also linked to the decisions we take on what to do going ahead with the cash, but our philosophy remains the same that if we don't see any long-term use for the cash, we will find some ways of returning it to shareholders the excess part.

Ashish Shah: Any clarity on the time line for completion of the E&A business sale?

Arnob Mondal: Right in the beginning, we had said it could take anything between 12 to 18 months, so I would not like to do any crystal ball gazing on that front.

Moderator: Thank you. The next question is from the line of Charanjit Singh from DSP Mutual Fund. Please go ahead.

Charanjit Singh: From which segments, what kind of large orders would be there in this prospects which got deferred of Rs 20,000 crores?

Arnob Mondal: We would not like to talk about individual orders Charanjit Singh, sorry.

Charanjit Singh: And now if I look at the prospect segments, which you have talked about being metro rail water resources, so some of these segments may not have that kind of complexity or margin profile, which we might be looking forward to, so how do you see some of the other larger projects like the high-speed train or in the hydrocarbon side, which are kind of projects which we will be targeting?

Arnob Mondal: See here again, I would not like to talk about any individual projects and I think we have discussed this before. I don't know whether you heard me earlier but the fact is that we don't bid for projects which offer suboptimal margins, so if you are alluding to our bidding for projects like that I think your premise itself is slightly wrong, incorrect as far as our bidding strategy is concerned and whatever you say, for example, underground metro, it is not something where you will find 30 bidders bidding for a project. Lift irrigation in water, it is not where you will find 20 bidders bidding for a project, which you may find for a plain Vanilla road, even if it is Rs 500 crores, so we obviously pick and choose our spots and we chose projects, which chose adjacencies which are not so crowded and we ensure that we bid at a minimum margin profile for that particular business.

Charanjit Singh: And sir, on these unannounced orders, if you can just, I know you will not be able to give, but in terms of the segment or what kind of segments these would have come from?

Arnob Mondal: See, Charanjit, my answer to you will be the same any which way you ask the question. You will have to be content with that.

Moderator: Thank you. The next question is from the line of Pulkit Patni from Goldman Sachs. Please go ahead.

Pulkit Patni: Sir, my first question is on the dividend from subsidiaries, do you have the number for the first 9 months, what is the total dividend that subsidiaries have given to the parent?

Arnob Mondal: Dividend from subsidiaries of first 9 months is Rs 1150 crores approximately.

Pulkit Patni: And would you have the Y-o-Y number also sir, what was it same for?

Arnob Mondal: Rs 1150 crores versus **Rs** 475 crores last year.

Pulkit Patni: Sir, second question is since you have kept your guidance same, I just wanted to get your view on how you expect working capital to pan out in the next 3 months, since we are heading into a big election, execution as you said should remain strong, could we see a little bit of working capital expansion just for the next 3 months?

Arnob Mondal: Very difficult to answer Pulkit. At any point of time, we have done 600 to 700 projects and ultimately working capital is an aggregate of all those projects, but what we have said is that we will try to cap it at around 20% for the group as a whole, but again you would find some projects where working capital has gone up, some projects where they balance to pull back working capital and another thing which I think which you need to take into account is that fourth quarter is the quarter when everybody goes all out for collections. In fact if you notice last year, fourth quarter working capital actually went down. Even the revenue growth was significantly high. So, I am hoping that we see the same phenomena in Q4 FY19 as well but fingers crossed, but as long as we are in the band of 20 to 21%, I think in this circumstances that is acceptable for us, but I don't think you will see a blowout if that is what you are alluding to.

Pulkit Patni: Yeah, that is what I wanted to check, may be one more question, since you spoke about 50% of the orders being fixed price, would it be fair to assume that part of the margin hit that we saw in this quarter was also because of commodity prices or is it just because of those transportation orders where we had to take provisions?

Arnob Mondal: The commodity prices in general have eroded some part of what could have been otherwise very healthy margins, but at the same time, our efforts on digitization particularly have to a large extent mitigated that, so the commodity price hike we have managed to mitigate through productivity improvements. Additional hit came from the extra provisions.

Moderator: Thank you. The next question is from the line of Girish Achhipalia from Morgan Stanley. Please go ahead.

Girish Achhipalia: Couple of questions. Sir firstly, the order book breakup if you can help us on centre, PSU, state and private, the broad breakup?

Arnob Mondal: Private is around 20%, centre is around 10%, state is around 32% and the balance is PSU close to 40%.

Girish Achhipalia: Sir, second question was just on the power sector, if you probably want to comment on the last 9 months as to how the new orders have happened in terms of both the profitability and the working capital, have you bid for all the orders or you refrain from bidding and how do you see the environment in the next couple of years?

Arnob Mondal: In some bids, we have refrained from bidding primarily because payment terms were just not acceptable to us, payment terms as embedded in the tender. So, wherever we find, we see that payment terms are acceptable, then we bid, but as you rightly mentioned there have been order bids where we have not bid, only because of payment terms.

Girish Achhipalia: And sir, any comment on sustainable margin for hydrocarbon, should this 9 months number be reflective of the trends going forward as well?

Arnob Mondal: See, worldwide hydrocarbon majors expect something around 8% EBITDA margin, so I think you can assume that these are more or less steady state margins, barring some ups and downs here and there, 8%

to 8.5% appears to be steady state, I would not like to go out and project anything further beyond this.

Moderator: Thank you. The next question is from the line of Kirthi Jain from Sundaram Mutual Fund. Please go ahead.

Kirthi Jain: On this infra segment, all the cost overruns have been booked or further anything is pending sir?

Arnob Mondal: See, whatever we can foresee at this point of time we have booked obviously. If we could foresee more costs, then obviously we would be under statutory obligation to book that.

Kirthi Jain: But going forward, based on the mix, will the margins improve sir in infra segment?

Arnob Mondal: See, obviously it should not. Q4 appears to be very low, obviously it should be better than Q3 but if you are talking about the year as a whole, it looks unlikely that we will touch last year's level, primarily because the large part of the claims that we have raised on customers are likely to come only subsequently in the next year, certainly not in this year. Some may come in this year, but most of it we envisage would happen coming in the next year, so infrastructure could see a bit of a margin dip for the year as a whole.

Kirthi Jain: Sir, recently like large infra players are facing stress like IL&FS and all, will we stand as a beneficiary because of stress or you see that the banking conditions will be tough for infra players that will adversely affect us, how you see this situation?

Arnob Mondal: As far as funding of infrastructure is concerned, most of the business that we are getting at this point of time is essentially from the public sector. Now, public sector, may be some PSU be availing a bank finance, but banking sector would obviously be far more amenable to lending to PSUs and to some private sector whose prominence they may not know, because even the PSU would have an implicit sovereign backing, but I don't think banks are very active in funding infrastructure projects as such and I think everybody knows that banks need further a very healthy dose of recapitalization in order to start lending in a big way again, so I would not really try to do any forecasting on that front, but IL&FS does not affect us directly as such.

Moderator: Thank you. As there are no further questions, I now hand the conference over to Mr. Arnob Mondal for closing comments.

Arnob Mondal: Thank you Ali. Thank you, ladies and gentlemen for a very patient hearing and an interactive question and answer session. Just before closing it, once again I would like to reiterate that just like one swallow does not make a summer, one quarter does not determine our fortunes going forward. You will see volatility from quarter to quarter whether it be in order inflows or revenue recognition or margin recognition primarily because of our policies and the nature of the business that we do; however, I think all of you would agree with me that we seem to be on a very safe and sound footing both in terms of financial strengths as well as the comfort of a very large order book as well as very fast growing and profitable services business segment. With that I would like to bring a close to this session and once again, thank you and good night ladies and gentlemen.

Moderator: Thank you. Ladies and gentlemen, on behalf of Larsen and Toubro Limited that concludes this conference call for today. Thank you for joining us and you may now disconnect your lines.